

PUBLIC DISCLOSURE

February 18, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Mercantile Bank Texas
Certificate Number: 22790**

**4500 Mercantile Plaza, Suite 100
P. O. Box 163049
Fort Worth, Texas 76161-3049**

**Federal Deposit Insurance Corporation
Division of Supervision and Consumer Affairs
1910 Pacific Avenue, 19th Floor
Dallas, Texas 75201**

NOTE: This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the Community Reinvestment Act (CRA) performance of **Mercantile Bank Texas** prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **February 18, 2003**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 345.*

INSTITUTION RATING

INSTITUTION'S CRA RATING: This institution is rated **Satisfactory**.

The FDIC also assigned a Satisfactory rating at the May 6, 1998, CRA performance evaluation.

Pursuant to the Community Reinvestment Act (CRA), Mercantile Bank Texas was evaluated under the performance factors applicable to small banks. These factors are loan-to-deposit ratio, lending to borrowers of different incomes and businesses of different sizes, lending in the assessment area, geographic distribution of lending, and response to CRA related complaints. Since no CRA related complaints were received since the previous evaluation, this factor was not considered in the overall rating. At management's request investments and services were not reviewed.

Commercial lending activities were chosen for evaluating the bank's performance. Mercantile Bank Texas' overall performance is considered satisfactory based on the following conclusions regarding each assessment criterion.

- Adequate performance has been demonstrated through maintaining stable loan-to-deposit ratios during a period of significant growth. The bank's performance compares favorably to other similarly sized institutions operating in the assessment area.
- Lending to businesses of different sizes displays adequate performance. The bank extended the majority of the number of loans reviewed to borrowers reporting gross annual revenues less than \$1 million, and over 55 percent of the loans sampled were for less than \$100,000.
- Lending in the assessment area displays satisfactory performance. The bank originated a substantial majority of both the number and dollar volume of the loans reviewed within the assessment area.
- Geographic distribution of lending is adequate. Loans are distributed throughout various income level geographies in a manner consistent with demographic data.

Please refer to the body of this evaluation for a detailed analysis of each performance factor.

DESCRIPTION OF INSTITUTION

Mercantile Bank Texas is an independently owned institution that has experienced over 266 percent growth since the previous CRA performance evaluation. This planned growth was achieved through the establishment of branches in Hurst, Arlington, and Bedford. The bank operates four onsite automated teller machines (ATM) and two off site ATMs located in the Federal Aviation Administration and Sprint PCS buildings in Fort Worth. Only the ATM at the Bedford branch accepts deposits. Growth is concentrated in commercial loan area. Operating hours at the various locations are appropriate for the communities served. All locations have extended Friday and Saturday hours. The bank offers a variety of consumer and commercial deposit accounts and extends commercial, commercial real estate, residential real estate, and consumer loans.

As of the September 30, 2002, Report of Condition and Income, the bank reported assets totaling \$182.4 million, 56 percent of which were loans. Tables 1 and 2 illustrate the composition of the bank's assets and the distribution of the loan portfolio. Table 3 provides a listing of the bank's offices.

<i>Table 1 – Asset Distribution as of 09/30/02</i>		
<i>Asset</i>	<i>Dollar Amount (000s)</i>	<i>Percent of Total Assets (%)</i>
<i>Net Loans and Leases</i>	102,471	56.2
<i>Cash & Non-interest-bearing Balances</i>	27,494	15.1
<i>Securities</i>	44,409	24.3
<i>Premises and Fixed Assets</i>	4,681	2.6
<i>Other Assets</i>	3,357	1.8
<i>Total Assets</i>	<i>182,412</i>	<i>100</i>

Source: Report of Condition

<i>Table 2 - Loan Distribution as of 09/30/02</i>		
Loan Type	Dollar Amount (000s)	Percent of Total Loans (%)
Construction and Land Development	22,561	21.8
Secured by Farmland	0	0
1-4 Family Residential	10,104	9.7
Multi-Family (5 or more) Residential	0	0
Commercial	33,810	32.7
Total Real Estate Loans	66,475	64.2
Commercial and Industrial	33,006	31.9
Agricultural	0	0
Consumer	4,634	4.5
Other	9	Nil
Less: Unearned Income	(559)	(.6)
Total Loans	103,565	100

Source: Report of Condition

Table 3 – Distribution of Offices		
City	Census Tract (CT)	CT Income Level
Fort Worth	1050.06	Low
Hurst	1136.12	Upper
Arlington	1131.07	Upper / Next to moderate-income tracts
Bedford	1136.18	Upper / Next to a moderate-income tract

Source: Bank Records and CRA Wiz

DESCRIPTION OF ASSESSMENT AREA

The assessment area consists of Tarrant County, one of four counties comprising the Fort Worth/Arlington Metropolitan Statistical Area. Tarrant County encompasses 269 census tracts. The 1990 U.S. Census data disclosed that the assessment area contains 28 low, 66 moderate, 92 middle, and 83 upper-income census tracts. Census data reported the population of the assessment area to be 1,170,103.

Fort Worth's strengths were identified by Economy.com, Incorporated to include very low costs of doing business, ample room for expansion, a highly affordable housing market, and a modern transportation infrastructure. Weaknesses were identified as a high exposure to defense, a high dependence on the volatile airline transportation industry, and heavy reliance on one employer, American Airlines.

The local economy hit bottom and shows slow but continuous improvement. Payrolls rose for two consecutive months prior to November 2002, which was led by growth in services and government employment. Manufacturing remains weak, but its pace of deceleration is at a standstill. Transportation and trade remain the weakest segments of the Fort Worth economy. This is attributed to transportation activity related to subdued manufactured goods, depressed air travel, and weak tourist travel. The unemployment rate has stabilized after rising by nearly 300 basis points since early 2001. However, unemployment rates continue to be comparable to state and national unemployment rates. Credit continues to deteriorate as evidenced by personal bankruptcy filings in the area that are the highest among major Texas metro areas.

The news of American Airlines restructuring is of high importance. As the largest employer in the metro area, American is important not only for the jobs it creates but also as the central anchor for DFW International Airport. American's restructuring will result in approximately 7,000 job losses nationwide and will include Fort Worth. Perhaps of greater importance is American's decision to fly fewer planes over more spread out periods of time. American plans to cut its fleet in Fort Worth by nine planes, which will result in layoffs among maintenance staff. Delta also announced a planned layoff of 1,500 flight attendants nationally and this will also have a local impact.

Fort Worth's major upside potential comes from its close links to the defense industry anchored by Lockheed Martin. Employment at Lockheed has risen by 2,000 employees since October 2002, and a combination of backlogged defense contracts provides expectations of more defense hiring over the next few years. The industrial real estate market is considerably more sound than in neighboring Dallas. Although vacancy rates have risen over the past year, they remain fairly stable because Fort Worth has not experienced the additions to its industrial stock that Dallas has. A solid footing exists although new construction is down and rents are weaker. As demand falls in line with a more robust economic recovery, Fort Worth's industrial real estate market should recover handsomely.

Income growth in Fort Worth has slowed dramatically over the past year. After leading the state and nation for much of the past decade, Fort Worth's income growth has dipped below the national and state average. Economic growth is expected to remain muted until the second half of 2003. A high concentration of lagging industries such as transportation, distribution, and telecom temper economic recovery.

A community was conducted in Bedford during this evaluation. The interviewee perceived the local economy to have leveled off, but sales tax revenues did not indicate an economic upswing. The area is approximately 98 percent built out for residential real estate and revitalization of older residential areas is evident. Economic growth is centered in smaller companies and service industries, creating a need for commercial loans. Mercantile Bank Texas was recognized as the bank most willing to step forward and is recognized for its personal relationship marketing.

Table 4 summarizes additional demographic information for the assessment area.

Table 4 - Demographic Information for Tarrant County					
Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #
Geographies (Census Tracts)	269	10.4	24.5	34.2	30.9
Population by Geography	1,170,103	5.7	25.5	36.7	32.1
Businesses by Geography	97,854	9.5	20.0	34.1	36.4

Source: 1990 US Census

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Sampling Information

Mercantile Bank Texas' performance was based on commercial lending activities in 2001 and 2002. Table 5 stratifies loans originated during the evaluation period by loan type.

Table 5 – Loans Originated				
Loan Type	Dollar Amount (000s)	Percent	Number of Loans	Percent
Construction & Land Development	74,349	41.2	363	16.7
1-4 Family Residential	15,501	8.6	211	9.7
Commercial Real Estate	18,740	10.3	66	3.0
Total Real Estate	108,590	60.1	640	29.4
Commercial & Industrial	66,148	36.6	1,068	49.1
Consumer	5,909	3.3	466	21.5
Total*	180,647	100	2,174	100

*Figures include loans that were originated and paid out during the period analyzed. Data included in the table was provided by bank management.

Table 5 discloses that the bank's business strategy was centered in commercial lending during the period being evaluated. As illustrated, commercial lending is the bank's primary product representing 88 percent of the bank's loan portfolio, with 37 percent being concentrated in commercial and industrial loans. Due to the bank's increased emphasis on commercial lending, this product was deemed the most appropriate to evaluate the bank's performance. Home mortgage loans represent less than 10 percent of the bank's lending activity and are primarily made to accommodate commercial clientele. Only four owner-occupied home purchase loans were extended in the previous two years, and 50 percent of all the home mortgage loans extended were secured by non-owner occupied dwellings. As such, home mortgage lending was not considered a key influence on the bank's performance and was not analyzed. Consumer lending was not reviewed because consumer loans have significantly declined since the previous evaluation and represent a nominal amount of the bank's lending activities.

From a universe of 170 commercial loans, a sample of 38 loans were reviewed for analyzing lending to businesses of different sizes and geographic distribution of lending. Lending inside the assessment area was based on the total universe of loans.

Loan-to-Deposit Ratio

Mercantile Bank Texas meets standards for this criterion. One measure of a bank's lending activity is the loan-to-deposit ratio (LTD), which compares the volume of loans to the volume of deposits. This institution's average LTD for the eighteen quarters since the previous evaluation was 58.27 percent. Subject bank's LTD compares favorably to banks similar in size and offering comparable loan products. Comparable banks are detailed in Table 6 and are listed in alphabetical order to avoid the appearance of ranking.

Table 6 – Loan-to-Deposit Ratios (Comparable Banks)					
Institution	City	Total Assets (000s)	Total Loans (000s)	Average LTD	LTD 09/30/02
First Bank	Azle	147,267	82,840	59.63	61.67
First Financial Bank	Cleburne	204,277	108,107	58.61	60.08
<i>Mercantile Bank Texas</i>	<i>Fort Worth</i>	<i>182,412</i>	<i>102,471</i>	<i>58.27</i>	<i>61.67</i>
Weatherford National Bank	Fort Worth	200,490	94,668	49.94	53.94

Source: Consolidated Reports of Condition and Income

Although the bank has experienced significant growth since the previous evaluation, a stable LTD has been maintained. Mercantile Bank Texas operates within a highly competitive market with numerous other financial institutions, credit unions, and mortgage companies. The bank's level of lending reflects a positive effort to meet the credit needs of the areas served.

Lending to Businesses of Different Sizes

Satisfactory performance was displayed for lending to businesses of different sizes. Tables 7 and 8 present the distribution of commercial credits reviewed by size and gross annual revenues. As illustrated, satisfactory performance is displayed in the distribution of loans by size, with the majority of the number of loans extended for less than \$100 thousand. As displayed in Table 8, 58 percent of the loans were extended to businesses reporting gross annual revenues less than \$1 million. Performance in lending to businesses of different sizes is judged by analyzing the size of loans extended and the gross annual revenues of the borrowers. Taking both these criteria into consideration, satisfactory performance was displayed.

Table 7 - Distribution of Commercial Loans by Loan Size				
Loan Size (000s)	Number of Loans		Dollar Volume	
	#	%	\$	%
<100	21	55.3	769	7.4
100 – 249	9	23.7	1,290	12.5
250 – 499	3	7.9	950	9.2
500 – 999	2	5.3	1,350	13.0
> 1 Million	3	7.8	6,000	57.9
Total*	38	100	10,359	100

Source: Bank Records

Table 8 – Distribution of Commercial Loans by Gross Annual Revenues of Business				
Gross Annual Revenues (000s)	Evaluation Period		Evaluation Period	
	#	%	\$	%
<100	2	5.3	33	0.3
100 – 249	1	2.6	175	1.7
250 – 499	8	21.1	2,372	22.9
500 - 999	11	29.0	1,537	14.8
>1 Million	16	42.0	6,242	60.3
Total*	38	100	10,359	100

Source: Bank records CRA Analyzer, Disclosure Statements (2001), CRA data collection (2001-2002), and CRA Aggregate Data

Lending in Assessment Area

The level of lending in the assessment area was satisfactory. Lending in the assessment area takes into consideration the size of the institution, the bank's branching network, and the areas being served. Table 9 displays that a substantial majority of the loans reviewed, 95 percent by both number and dollar volume, were originated with the designated assessment area. This is to be expected since the assessment area is considerably larger than the bank's marketing territories. As such, the bank has demonstrated satisfactory performance.

Table 9 – Distribution of Loans Inside and Outside of the Assessment Area									
Number of Loans					Dollars in Loans (000s)				
Inside		Outside		Total	Inside		Outside		Total
#	%	#	%		\$	%	\$	%	
161	94.7	9	5.3	170	30,200	94.8	1,653	5.2	31,853

Geographic Distribution of Lending

The bank's distribution of lending was satisfactory. Table 10 discloses that the loans reviewed were reasonably distributed throughout the various census tract income levels. Lending activity compares favorably to the distribution of businesses throughout the assessment area.

Table 10 - Distribution of Commercial Loans by Income Category of the Census Tract					
Census Tract Income Level	Distribution of Businesses	Evaluation Period (2001-2002)		Evaluation Period (2001-2002)	
		#	%	\$	%
Low	9.5	2	5.3	340	3.3
Moderate	20.0	10	26.3	1,314	12.7
Middle	34.1	15	39.5	2,154	20.8
Upper	36.4	11	28.9	6,551	63.2
Total*	100	38	100	10,359	100

Source: Bank records, 2002 Business Geodemographic Data

Response to Complaints

The bank has received no consumer complaints relative to its performance under the Community Reinvestment Act. Therefore, this factor did not impact the performance evaluation.

Fair Lending

No violations of the substantive provisions of the anti-discrimination laws and regulations were identified. Bank policy and practices support nondiscrimination in lending and credit-related activities. Lending activities reviewed by examination personnel found no evidence that management has engaged in any unlawful or discriminatory acts.

GLOSSARY

GEOGRAPHY TERMS

Census Tract: Small subdivisions of metropolitan and other densely populated counties.

Census tract boundaries do not cross county lines; however, they may cross the boundaries of metropolitan statistical areas. They usually have between 2,500 and 8,000 persons, and their physical size varies widely depending upon population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

Metropolitan Area (MA): One or more large population centers and adjacent communities that have a high degree of economic and social integration. Each MA must contain either a place with a minimum population of 50,000 of Census Bureau-defined urbanized area and a total MA population of at least 100,000 (75,000 in New England). An MA comprises one or more central counties and may include one or more outlying counties that have close economic and social relationships with the central county. In New England, MAs are composed of cities and towns rather than whole counties.

Metropolitan Statistical Area (MSA): One or more metropolitan areas that have economic and social ties.

HOUSING TERMS

Household: Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

Owner-Occupied Units: Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

INCOME TERMS

Area Median Income: The median family income for the MSA, if a person or geography is located in an MSA; or the statewide non-metropolitan median family income, if a person or geography is located outside an MSA.

Low-Income: Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent in the case of a geography.

Moderate-Income: Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent in the case of a geography.

Middle-Income: Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 and less than 120 percent in the case of a geography.

Upper-Income: Individual income that is more than 120 percent of the area median income, or a median family income that is more than 120 percent in the case of a geography.

HUD Adjusted Income Data: The U.S. Department of Housing and Urban Development (HUD) issues annual estimates, which update median family income from the metropolitan and non-metropolitan areas. HUD starts with the most recent U.S. Census data and factors in information from other sources to arrive at an annual estimate that more closely reflects current economic conditions.

OTHER TERMS

Home Mortgage Disclosure Loan Application Register (HMDA LAR): The HMDA LARs record all applications received for residential purchase, refinance, home improvement and temporary-to-permanent construction loans.

Small Business Loan: A loan included in “loans to small businesses” as defined in the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$1 million or less and are either secured by non-farm nonresidential properties or are classified as commercial and industrial loans.

Dun & Bradstreet: The Dun & Bradstreet Corporation is a provider of business and financial information drawn from a global database of more than 50 million businesses.